Supreme Court, U.S.
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No. 92-1427

In the Supreme Court of the United States

OCTOBER TERM, 1992

INDIANA NATIONAL CORPORATION AND INDIANA NATIONAL BANK, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the 7-year statute of limitations in Section 6511(d)(1) of the Internal Revenue Code for refund claims arising from the carryback of certain bad debt deductions or the 38 1/2-month statute of limititations in Section 6511(d)(2)(A) and (d)(4)(A) of the Code for refund claims attributable to net operating loss carrybacks applies to the refund claim for a net operating loss carryback in this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A24) is reported at 980 F.2d 1098. The opinion of the district court (Pet. App. A25-A66) is reported at 775 F. Supp. 281.

JURISDICTION

The judgment of the court of appeals was entered on November 30, 1992. The petition for a writ of certiorari was filed on February 26, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners are members of an affiliated group of corporations. In September 1974, they filed a consolidated income tax return for 1973 which reported a net operating loss to which a bad debt deduction had contributed (Pet. App. A2-A3). In December 1974, petitioners filed an amended income tax return for 1973, in which they reduced the amount of the claimed bad debt deduction (*id.* at A3).[1] At the same time, they filed applications for tentative carryback adjustments and refunds, claiming a tentative refund of $976,764 for 1970 and of $971,297 for 1967 (*id.* at A3-A4).[2]

On September 15, 1977, petitioners filed amended income tax returns for 1967 and 1970 (the carryback years) claiming refunds for the overpayments that resulted in those years as a consequence of carrying back the net operating loss that petitioners incurred in 1973 (the loss year). Petitioners claimed a $1,008,274 refund for 1970 based upon the carryback to 1970 of the net operating loss reported in petitioners' amended return for 1973 (Pet. App. A4, A31). They claimed an overpayment of $862,466 for 1967 based upon the carryback from 1970 to 1967 of an investment tax credit that was freed up by the carryback to 1970 of the 1973 net operating loss (*ibid.*).

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[1] Although petitioners ultimately filed three amended returns for 1973 reporting various changes in the amount of their net operating loss for the year, the only adjustments to the bad debt deduction for 1973 were reductions in the amount of that deduction (Pet. App. A30-A31). See Pet. 8-9.

[2] An application for a tentative carryback adjustment and refund does not constitute a claim for credit or refund. 26 U.S.C. 6411(a).

The Internal Revenue Service concluded that petitioners' refund claims were untimely. Petitioners then brought this action for a refund in federal district court.

2. The district court concluded that petitioners' refund claims for 1967 and 1970 were barred by the statute of limitations (Pet. App. A25-A66).[3] Petitioners' refund claim for 1970 resulted from carrying back to that year the net operating loss they incurred for 1973. Section 6511(d)(2)(A) of the Internal Revenue Code, as then in effect, provided (26 U.S.C. 6511(d)(2)(A) (1976)):

> If the claim for credit or refund relates to an overpayment attributable to a net operating loss carryback * * *, in lieu of the 3-year period of limitation prescribed in subsection (a), the period shall be that period which ends with the expiration of the 15th day of the 40th month (or the 39th month, in the case of a corporation) following the end of the taxable year of the net operating loss * * * which results in such carryback * * *.

The court concluded that, under this provision, the time for petitioners to file a claim for refund of an overpayment attributable to a net operating loss expired 38 1/2 months after the end of the year in which the net operating loss was incurred (Pet. App. A61). The year of the net operating loss (the loss year) in this case was 1973, and the limitations period prescribed by Section 6511(d)(2)(A) for filing a refund claim for petitioners' overpayment for 1970 therefore expired 38 1/2 months after December 31, 1973—on March 15, 1977.

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[3] Petitioners also sought a refund for 1973. The parties agreed that the 1973 refund claim was timely and that petitioners were entitled to a refund of $20,918 for that year (Pet. App. A67-A68). The 1973 refund claim is therefore not involved at this stage of the case.

The court further concluded that petitioners' 1967 refund claim was controlled by the separate rule provided in Section 6511(d)(4)(A) of the Code, 26 U.S.C. 6511(d)(4)(A) (1976) (Pet. App. A61). That statute established a limitation period for corporate taxpayers of 38 1/2 months after the close of the loss year "with respect to any portion of an investment credit carryback from a taxable year attributable to a net operating loss carryback * * * from a subsequent taxable year." 26 U.S.C. 6511(d)(4)(A) (1976). The time provided by Section 6511(d)(4)(A) for filing petitioners' refund claim for 1967 (which was attributable to the carryback to 1967 of 1970 investment credits freed up by the carryback to 1970 of the net operating loss incurred in 1973) also expired on March 15, 1977. Since petitioners did not file their refund claims for 1967 and 1970 until September 15, 1977, the claims were barred by these statutes of limitations (Pet. App. A61, A63).

The district court rejected petitioners' contention that the period of limitations applicable to the filing of their 1967 and 1970 refund claims was the 7-year period for filing refund claims arising from the carryback of losses from bad debt deductions under Section 6511(d)(1) of the Code, 26 U.S.C. 6511(d)(1) (1976). That Section states (*ibid.*):

> If the claim for credit or refund relates to an overpayment on account of the effect that the deductibility of * * * a [worthless] debt * * * has on the application to the taxpayer of a carryback, the period shall be * * * 7 years from the date prescribed by law for filing the return for the year of the net operating loss which results in such carryback * * *.

The court concluded that the 7-year period provided in Section 6511(d)(1) of the Code is available only when the

fact that bad debt deductions were understated was discovered after the date the original return was filed for the year of the claimed bad debt deduction (Pet. App. A46-A49). Petitioners were not entitled to the benefit of a 7-year limitations period under Section 6511(d)(1) because they knew of all of their 1973 bad debt deductions before they filed their original tax return for 1973 and the subsequent adjustments to their bad debts claimed for 1973 all *reduced* the amount of that deduction. The court noted that its interpretation of these statutes was consistent with the IRS's longstanding administrative rulings (Pet. App. A59-A61, citing Rev. Rul. 55-523, 1955-2 C.B. 497).[4]

3. The court of appeals affirmed (Pet. App. A1-A24). The court explained that the special 7-year limitations period of Section 6511(d)(1) applies to taxpayers who determine *after* filing the return for the year of the net operating loss that they should have taken bad debt deductions (or have understated their bad debt deductions) for that year (Pet. App. A20-A21). The court of appeals concluded that petitioners' claims for refund were governed by Section 6511(d)(2) and (4) of the Code and were therefore untimely (Pet. App. A21).

ARGUMENT

The decision below is correct and does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Petitioners seek to recover refunds of alleged overpayments of income taxes for 1967 and 1970. For the

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[4] The district court also rejected petitioners' alternative argument that their claims for refund of 1967 and 1970 income taxes were timely by reason of petitioners' consent to an extension of the time for the assessment of certain excise tax liabilities incurred in 1973 (Pet. App. A62-A66). Petitioners have not raised this issue in the petition for a writ of certiorari.

district court to have jurisdiction over these claims, they must have been filed within the period provided by the applicable statutes of limitations. See *United States* v. *Dalm*, 494 U.S. 596, 602 (1990). The dispute in this case concerns which of two statutes of limitations governs the filing of petitioners' claims.

The courts below correctly held that, under the plain language of Sections 6511(d)(2)(A) and 6511(d)(4)(A) of the Code, since petitioners filed their refund claims arising from net operating loss carrybacks and credit carrybacks *after* the 38 1/2-month period provided by those Sections had expired, the district court lacked jurisdiction in this case (Pet. App. A21, A61). Petitioners assert, however, that the limitations period of those provisions is qualified by Section 6511(d)(1), which provides a 7-year statute of limitations for certain loss-carryback refund claims attributable to bad debt deductions. Petitioners claim (Pet. 14-26) that their 1967 and 1970 refund claims come within Section 6511(d)(1) because included among their 1973 deductions was a bad debt deduction larger in amount than their net operating loss for the year.[5]

As the courts below held (Pet. App. A17-A21, A61), however, to qualify for the extended 7-year limitations period of Section 6511(d)(1), more is required than merely having a net operating loss carryback to which a bad debt deduction contributed. Section 6511(d)(1) applies to a claim for refund for a carryback year only when the net operating loss was created (or increased) by a discovery made *after* the original return was filed that a debt had become worthless during the return year. The

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[5] Petitioners' deductions in 1973 totaled approximately $149 million (Pet. App. A28). Petitioners' 1973 net operating loss of $4 million existed because their 1973 income was less than the sum of *all* their 1973 deductions, including their $6 million bad debt deduction.

House Report on these provisions explained that Section 6511(d)(1) was needed to protect a taxpayer for whom "[l]ater evidence" disclosed a miscalculation about the year in which a debt became worthless (H.R. Rep. No. 2333, 77th Cong., 2d Sess. 44-45 (1942), cited at Pet. App. A13-A14). The Internal Revenue Service has long interpreted the statute to have precisely this meaning (Rev. Rul. 55-523, 1955-2 C.B. 497). The agency's interpretation is entitled to substantial deference. *E.g.*, *Davis* v. *United States*, 495 U.S. 472, 484 (1990); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 144 (1989); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 476-477 (1979).

The 7-year limitations period of Section 6511(d)(1) does *not* apply where the amount of the bad debt deduction that was reported in the original return either decreases (as in this case) or remains unchanged. If the amount of the originally reported bad debt deduction is reduced or stays the same, then the decrease (or lack of change) in the bad debt deduction does not create or increase the loss that the taxpayer is already entitled to carry back. Section 6511(d)(2) of the Code provides a specific period of limitations for refund claims relating to the carryback of net operating losses in general, including net operating losses to which bad debt deductions have contributed. It is only when a bad debt is discovered *after* the filing of the return for the year in which the debt became worthless that the special 7-year period of Section 6511(d)(1) applies.

Even if Section 6511(d)(1) of the Code were ambiguous in this regard, as a statute of limitations that conditions the government's waiver of sovereign immunity, it is to be strictly interpreted in favor of the sovereign. See *United States* v. *Nordic Village, Inc.*, 112 S. Ct. 1011, 1014-1015 (1992); *United States* v. *Dalm*, 494 U.S. at 608. The ambiguity that petitioners contend exists in the

statute does not provide a basis for a conclusion that sovereign immunity has been waived. See *United States* v. *Nordic Village, Inc.*, 112 S. Ct. at 1016.

For these several reasons, the court of appeals correctly concluded (Pet. App. A21) that Section 6511(d)(1) is not applicable on the facts of this case.

2. Petitioners err in contending (Pet. 57-64) that the decision of the court of appeals conflicts with the decision of the Court of Claims (now the United States Court of Appeals for the Federal Circuit) in *Smith Electric Co.* v. *United States*, 461 F.2d 790 (Ct. Cl. 1972). In *Smith Electric*, the Court of Claims permitted the taxpayer's refund claim for a carryback year to proceed under the 7-year limitations period of Section 6511(d)(1) even though the only bad debt deduction involved had been reflected in the taxpayer's original return for the loss year. 461 F.2d at 791. But in *Smith Electric*, the court did not address or decide the issue presented in this case. Instead, as the court noted in *Smith Electric*, *id.* at 791 (emphasis added; footnote omitted):

> The *sole* issue in this case is whether the special seven-year statute of limitations, with respect to filing claims for refund on account of the deductibility of a worthless debt, is applicable to taxpayers on the reserve method as well as to those on the direct charge-off method.

As the district court (Pet. App. A59) and the court of appeals (Pet. App. A14 n.3) stated, the decision in *Smith Electric* did not address or decide—and thus creates no conflict on—the issue presented in this case.

The precise question presented in this case *was* presented to, and decided by, the Court of Claims in *Armstrong* v. *United States*, 681 F.2d 774 (Ct. Cl. 1982). In *Armstrong*, as in this case, the taxpayers reported a net operating loss (to which a bad debt deduction had con-

tributed) in their original return for 1975, but they failed to file claims for refund for the years to which that loss could be carried back until after the period prescribed in Section 6511(d)(2)(A) of the Code had expired. 681 F.2d at 775, 776. The taxpayers in *Armstrong* nevertheless argued—as petitioners do here—that their refund claims were timely under the 7-year period of Section 6511(d)(1). 681 F.2d at 776. The Court of Claims rejected that contention (*id.* at 776-777):

> It would certainly appear that Congress did not have plaintiffs' situation in mind when the special bad debt limitation section was first enacted. The 7-year period was designed to prevent possible prejudice to those taxpayers whose otherwise legitimate deduction might be placed in jeopardy by the general 3-year period. No such risk extends to a taxpayer whose bad debt deduction is taken on the original return for the year. Congress was attempting to prevent a possible injustice, not simply providing an extra 4-year grace period for dilatory taxpayers.

The Court of Claims concluded that Section 6511(d)(2)(A), not Section 6511(d)(1), governs in this situation (681 F.2d at 778; footnote omitted):

> [T]he alleged overpayments * * * are not "on account of" the deductibility of a bad debt—plaintiffs took a bad debt deduction in 1975 which has not been contested. Rather, plaintiffs' overpayment resulted from the failure to utilize the NOL carryback provisions (section 172) within the time allotted under statute. The proper provision to be considered, then, is the NOL limitation period specified in section 6511(d)(2)(A), not the bad debt limitation period of section 6511(d)(1).

The decision in this case is therefore consistent with the Court of Claims' decision in *Armstrong* and does not conflict with that court's earlier decision in *Smith Electric*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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